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E.O. 12958: DECL: 01/08/2019
TAGS: EAIR EFIN ECON ETRD OPIC USTR MP
SUBJECT: AIR MAURITIUS CAN'T FLY OVER THIS HEDGE,
GOVERNMENT ENTANGLED

Classified by Ambassador Cesar B. Cabrera for Reason 1.4(d).

¶1. (C) SUMMARY: Air Mauritius made a very bad bet. After increasing its hedge ratio to 80 percent of its projected fuel requirements until mid-2010 at an average price of USD 105 per barrel, the airline is losing about USD 8.4 million per month. These severe self-inflicted losses have led to stop-gap government rescue funds and a government demand for a reform plan. The ruling Social Alliance will attempt to rescue and restructure the publicly-owned company with the least amount of political backlash, but success is not guaranteed. END SUMMARY.

Avoiding an Airline Crash

¶2. (SBU) The Board of Directors of Air Mauritius (which includes an Air France Executive Vice President) and the GOM, its principal shareholder, are currently working on an urgent rescue plan to avoid the crash of the national airline. After reviewing the company's financial situation, particularly the growing impact of the fuel price on the company's hedge profile and the drop in demand for air travel worldwide, the Board indicated in a public communique dated December 26 that the current situation is worse than initially forecast and that the company's financial results for the financial year ending March 31, 2009 will be "significantly impacted." The communique added that "the additional measures envisaged to face this unprecedented situation are being finalized and will be implemented urgently."

Was the High Hedge a Fuelish Bet?

¶3. (SBU) As revealed in a series of news stories beginning in late December 2008, Air Mauritius decided in August 2008, at a time when the price of oil was soaring, to increase its hedge ratio to 80 percent of its projected fuel requirements for the next two years (i.e. to the end of July 2010) at an average price of USD 105 per barrel. The subsequent drastic fall in fuel prices (to as low as USD 35 per barrel recently) represents a loss of USD 8.4 million per month for Air Mauritius, with devastating consequences for the company's cash flow. That the spending hemorrhage coincided with a world-wide slump in tourist travel, the source of nearly all Air Mauritius' revenue, meant the company was bleeding uncontrollably just as its oxygen intake was being choked off. In the context

of the international financial crisis, the hedge counterparties (Barclays, BNP, Mitsui Corporation and Merrill Lynch) insisted that Air Mauritius provide cash or cash equivalent collateral for the two-year contract period. Given Air Mauritius' precarious liquidity situation, the GOM stepped in with the necessary guarantee (USD 110 million), which allowed the company to release cash resources which were pledged as security to the counterparties.

A Cyclone of Commentary

¶4. (SBU) Since the news broke, Air Mauritius' management has faced a barrage of criticism from various quarters on the way it handled the hedging agreement. In an interview given to "l'express," a widely-read local daily, one shareholder asserted that it was irresponsible for Air Mauritius to enter a two-year hedging contract. "A six-month contract would have been more reasonable," he added. In another interview, the director of an asset management company expressed surprise that Air Mauritius did not "take a second short-term cover" in anticipation of a possible major drop in fuel prices. "This would have saved the company the hedge loss of Rs 4.4 billion (USD 138 million) for the two-year contract period," he asserted. In the aviation sector, people are wondering why the Air Mauritius Risk Management Committee increased its hedging ratio from the normal 50 percent to 80 percent of its fuel requirements. Air Mauritius CEO Manoj Ujoodha claims that the hedging decision was good at the time it was made.

"It's easy to be wise after the event. Who would have predicted that the price of fuel would have dropped so low," he commented to "le Mauricien," another local newspaper. He claims the global financial crisis and its consequences on air travel demand have affected the airline more than the hedging contract itself.

Rescue Me! (Without Pain, Please)

¶5. (SBU) Air Mauritius' Board of Directors is expected to submit its reform or rescue plan to the GOM in January. According to "Business Magazine," a local weekly, Air Mauritius is considering several options, including a reduction of fleet. The company, however, maintains that it will finalize the purchase of a new Airbus (A330-200) in October 2009, increasing the fleet's size from 11 to 12 planes. "It's too late to cancel the order; the contract was signed in 2007," said Donald Payen, Air Mauritius Vice President for Communications, according to "Business Magazine." Air Mauritius' destinations and their frequencies might also be revised by the rescue plan. Players in the tourism industry are calling for a reduction in the price of air tickets. Although Air Mauritius is believed to have 450 employees in excess, cutting the workforce is unlikely to obtain consensus and would be an unpopular political move. Those in favor of a soft approach to layoffs argue that in such circumstances, the company needs more than ever the motivation of its employees. They pointed out that such a measure would go against the current GOM's efforts to preserve jobs in the context of the global economic crisis.

Governmental Grumbling

¶6. (SBU) In a statement to the weekly "le Mauricien" December 30, Finance Minister Rama Krishna Sithanen said he is against the privatization of Air Mauritius since he deems that "it is a strategic tool that is extremely

important for the country." He is also, however, against the massive injection of capital into the company in the absence of a new business model. He admits the situation is "very very difficult," and that he is not happy with the way Air Mauritius handled the hedging issue. "Some serious mistakes have been committed. There should have been more professionalism on this dossier," he added.

¶7. (SBU) The Prime Minister was harsher in the New Year. He was "said to be angry" with the company chairman in a page one "l'express" story January 5, and issued a statement full of complaints about the company to "le Mauricien" the same day, which included a request to the directors to reduce both company expenses and "the number of their visits abroad." The PM said he was waiting for a "reform plan" before committing to supplying additional funds.

¶8. (C) COMMENT: Given its strategic importance for the tourism industry, and thus for the Mauritian economy as a whole, Air Mauritius is "too big to fail." Nonetheless, the airline will not be easy to rescue. After the ruling Social Alliance's haste in asking struggling hoteliers not to lay off workers, it can hardly make drastic cuts to an admittedly fat work force at the national airline. On the other hand, it is not clear how much red ink Mauritius can afford. END COMMENT.

CABRERA